

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Mark Acton, Vice Chairman;
Tony Hammond; and
Nanci E. Langley

Periodic Reporting
(Proposal Two)

Docket No. RM2017-6

ORDER ON ANALYTICAL PRINCIPLES USED IN PERIODIC REPORTING
(PROPOSAL TWO)

(Issued August 29, 2017)

I. INTRODUCTION

On June 8, 2017, the Postal Service filed a petition pursuant to 39 C.F.R. § 3050.11 requesting that the Commission initiate an informal rulemaking proceeding to consider a proposal (Proposal Two) to change the analytical methods approved for use in periodic reporting.¹

On June 14, 2017, the Commission issued Order No. 3962 initiating this rulemaking proceeding, providing for the submission of comments and appointing a Public Representative.² On June 27, 2017, Chairman's Information Request No. 1 was

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Two), June 8, 2017 (Petition).

² Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Two), June 14, 2017 (Order No. 3962).

issued.³ The Postal Service responded to CHIR No. 1 on July 10, 2017.⁴ The Public Representative filed comments in response to Order No. 3962.⁵ No other comments were received.

For the reasons discussed below, the Commission approves Proposal Two.

II. BACKGROUND

During a review of the FY 2016 Annual Compliance Report (ACR), an issue arose regarding the Postal Service's calculation of separate unit costs for Inbound Letter Post (at UPU Rates) for Target System and Transition System countries.⁶ Currently, unit costs for inbound air and surface Letter Post items are developed separately for Target System countries and for Transition System countries. Those costs are then applied to the volume for each country as applicable.⁷

At the beginning of CY 2016, 19 countries moved from the Transition System to the Target System. *Id.* at 64. In its FY 2016 ACR filing, the Postal Service included all FY 2016 volume from these 19 countries in the Target System-specific unit cost calculation, which is inconsistent with the currently approved methodology for calculating Target System and Transition System-specific unit costs.⁸ To apply the currently approved methodology, the CY 2015 Quarter 4 volumes for these countries should have been used to develop Transition System-specific unit costs, and the CY 2016 Quarters 1-3 volumes to develop Target System-specific unit costs. *Id.*

³ Chairman's Information Request No. 1, June 27, 2017 (CHIR No. 1).

⁴ Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1, July 10, 2017 (Response to CHIR No. 1).

⁵ Public Representative Comments on Proposed Changes in Analytical Principles Used in Periodic Reporting (Proposal Two), July 31, 2017 (PR Comments).

⁶ Target System countries are mainly industrialized and newly industrialized countries as classified by the Universal Postal Union (UPU) for purposes of payments for the delivery of letter post among UPU member countries. Transition System countries are mainly developing countries.

⁷ Docket No. ACR2016, Annual Compliance Determination, March 28, 2017, at 63-34 (FY 2016 ACD).

⁸ Docket No. ACR2016, Library Reference USPS-FY16-NP2, December 29, 2016.

The Commission asked the Postal Service to explain its rationale for including all FY 2016 volumes from these 19 countries in developing the Target System-specific unit costs.⁹ Rather than explaining its use of the FY 2016 volumes for all quarters, the Postal Service's response presented an alternative methodology to remedy the issue.¹⁰ The alternative methodology calculated a separate single unit cost for each type of inbound mail category.¹¹

The Commission applied this new methodology for assessing Postal Service compliance in the FY 2016 ACD, recognizing, after a preliminary review, that it likely improved the accuracy of the cost estimates. However, because the methodology had not been previously approved, the Commission advised the Postal Service that, "the methodology must be reviewed by the Commission through a docketed proceeding before it can be used in future ACDs." *Id.* at 64. The Postal Service is seeking approval of that new methodology in this docket.

In its Petition, the Postal Service responds to Commission comments in the FY 2016 ACD regarding revisions made to the FY 2016 International Cost and Revenue Analysis (ICRA) during that proceeding. *Id.* at 63-65; Petition at 1. The Postal Service states that while the Commission's discussion linked the potential filing of Proposal Two to other topics that also affect the costs reported for international mail, these topics do not directly relate to Proposal Two and the Postal Service views consideration of Proposal Two as entirely independent of these other matters. Petition at 1.

⁹ Docket No. ACR2016, Chairman's Information Request No. 5 and Notice of Filing Under Seal, January 12, 2017, question 3.

¹⁰ Docket No. ACR2016, Response of the United States Postal Service to Questions 1-4 of Chairman's Information Request No. 5, January 19, 2017, question 3. The Postal Service amended the International Cost and Revenue Analysis (ICRA) on January 19, 2017 and February 3, 2017. See Library Reference USPS-FY16-NP2, January 19, 2017 (January 19, 2017 ICRA); Library Reference USPS-FY16-NP2 (Revised), February 3, 2017 (February 3, 2017 ICRA). See *also* FY 2016 ACD at 63 n.77.

¹¹ Inbound mail categories include Air and Surface Letter Post; Air and Surface Parcel Post; and Express Mail Service (EMS). *Id.*

Four of these topics can be grouped as International Service Center (ISC) issues.¹² Other topics relate to the number of In-Office Cost System (IOCS) tallies for international mail products for which an updated table is presented in the Postal Service's Petition. In addition, several issues concerning the ability to disaggregate international mail cost pools between market dominant and competitive products are still being examined by the Postal Service. These latter issues relate to the unique structure of international product offerings when calculating incremental costs. *Id.* at 2-3. The Commission agrees that Proposal Two may be reviewed independently of these issues.

III. PROPOSAL TWO

A. Postal Service Proposal

The Postal Service proposal has two components. First, the proposal would implement the costing methodology presented by the Postal Service in the FY 2016 ACR proceeding.¹³ The Postal Service proposes to change the costing methodology for the treatment of inbound mail, including Letter Post, Parcel Post, and EMS, to adjust for the difficulty of maintaining the statistical reliability of reporting UPU Target and Transition countries separately.¹⁴

¹² ISC issues relate to: (1) availability of ISC-level Management Operating Data System data; (2) machine productivity at ISC versus non-ISC facilities; (3) proportion of sacked versus non-sacked mail arriving at ISCs; and (4) proportion of properly labeled versus improperly labeled mail arriving at ISCs. *Id.* at 2.

¹³ Docket No. ACR2016, Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 12, February 6, 2017, question 1 (Docket No. ACR2016, Response to CHIR No. 12); Petition, Proposal Two at 6.

¹⁴ *Id.* at 1. The Target and Transition Country distinction applies only to terminal dues rates paid for Inbound Letter Post items. This distinction, which is the UPU designation for member countries paying terminal dues, has no application to Inbound Parcel Post or Inbound EMS. For analysis of inbound mail, however, the ICRA uses the industrialized countries (ICs) and developing countries (DCs) designation that was previously used by the UPU. In this Order, the terms Target and Transition with respect to Inbound Parcel Post (at UPU rates) and Inbound EMS are used to simplify the discussion and to recognize that the Postal Service's proposal also seeks to discontinue the development of separate unit costs for ICs and DCs for Inbound Parcel Post and Inbound EMS in the ICRA.

Second, the Postal Service proposes to more closely align the ICRA reporting of market dominant Letter Post products with the Mail Classification Schedule (MCS) by combining the reporting of cost and revenue of Inbound Letter Post from Target System and Transition System countries in the ICRA. The proposal maintains separate reporting for Inbound Letter Post from Canada. *Id.* at 1, 6. The proposed methodology also aggregates costs and volumes from both Target and Transition system countries to create a single unit cost for the other categories of inbound mail, *i.e.*, Inbound Parcel Post (at UPU rates) and Inbound EMS. *Id.* at 1.

Rationale. The Postal Service states that this change adjusts for the increasingly difficult task of reporting costs for UPU Target System and Transition System countries separately. *Id.* at 1. It asserts that the proposal improves the statistical reliability of Inbound Letter Post cost estimates. *Id.* at 2. The Postal Service also argues that combining the reporting of Inbound Letter Post from Target System and Transition System countries in the ICRA can improve reporting by aligning the ICRA with the MCS. *Id.*

The Postal Service points out that as more operators shift from the Transition System to the Target System, less data on Transition System countries will be available to estimate costs. *Id.* Costs for Canada are reported separately due to its longstanding bilateral agreement with the Postal Service. This agreement includes presort workshare requirements and lower transportation costs and represents such a large portion of international mail that continuing to separately report it is justified. *Id.* at 3.

In addition, the Postal Service asserts this proposal would align the ICRA reporting of market dominant Letter Post with the current MCS. *Id.* at 1. The MCS description of Inbound Letter Post makes no distinction between Target System and Transition System countries.¹⁵ The Postal Service asserts that no essential cost

¹⁵ Section 1130.1 of the MCS states in pertinent part: "Inbound Letter Post consists of inbound International pieces (originating outside of the United States and destined for delivery inside of the United States) that are subject to the provisions of the Universal Postal Convention of the Universal Postal Union and encompasses letters, packages, postcards, printed matter, and small packets, up to 2 kilograms...."

difference exists between Inbound Letter Post from Target System countries and Transition System countries and that splitting them into groups reduces the precision of the estimates. Petition, Proposal Two at 7. The UPU Target and Transition Country classifications depend on the economic development of countries, unrelated to the cost causing characteristics that should be reported. Additionally, the classifications continue to change as the UPU continues to move towards classifying all Transition System countries into the Target System. *Id.*

The Postal Service asserts, “there would no longer be a need for the IOCS analysis to separate costs into Target and Transition Countries in the CRA Cost Segments tab of the Inputs file.” *Id.* at 6. Furthermore, the Postal Service states that combining the mail from Target and Transition countries will reduce coefficients of variation (CVs) and improve precision of the estimates. *Id.* at 7.

Impact. The effects of implementing Proposal Two are detailed in an attachment to a non-public file.¹⁶ The attachment presents three versions of the ICRA summary tables and two sets of differences relative to results in another non-public file from Docket No. ACR2016. Petition, Proposal Two at 7. Three versions of the tables are included to allow for comparisons of the proposed version and two versions of the “status quo.” The “old status quo” is consistent with the methodology used in CY 2015 and CY 2016, and the “new status quo” represents the February 3, 2017 methodology filed in the FY 2016 ACD.¹⁷ The proposed version utilizes the same conceptual approach as the February 3, 2017 filing, but contains some refinements and corrections. Petition, Proposal Two at 8. The presentation of the calculations have been streamlined and certain data and calculations will be eliminated from future ICRAs. *Id.* at 12-13.

¹⁶ See Library Reference USPS-RM2017-6/NP1, June 8, 2017, Attachment 1.xlsx.

¹⁷ See Docket No. ACR2016, Response to CHIR No. 12, question 1; see also February 3, 2017 ICRA; FY 2016 ACD at 63 n.77.

B. Public Representative Comments

The Public Representative recommends that the Commission approve Proposal Two. PR Comments at 2. The Public Representative provides a useful history of the evolution of reporting Inbound Letter Post costs separately for Target and Transition System countries. *Id.* at 2-4. She states that countries in the Target System are not as homogeneous with regard to cost as they once were, and that only the original Target System countries are required to separate letter post by format. She concludes that it is therefore difficult to find meaning from attributable cost differences between the two groups. *Id.* at 4. Also, she explains that as Transition System countries continue to migrate to the Target System, less data will be available to estimate the cost of Inbound Letter Post from Transition System countries. *Id.*

The Public Representative concludes that separate reporting for Target System and Transition System country groups “is no longer relevant or useful.” *Id.* However, she notes the Postal Service should be mindful of cost differences between countries that separate Inbound Letter Post by format and those that do not. She asserts that unit attributable costs for Inbound Letter Post that is separated by format will be lower than those same costs for Inbound Letter Post that is not separated by format. *Id.*

C. Commission Analysis

Based upon a review of the Postal Service’s filing, supporting workpapers, and the Public Representative’s comments, the Commission finds that Proposal Two improves the quality and reliability of the Postal Service’s costing methodology for inbound mail, including Inbound Letter Post, Inbound Parcel Post, and EMS.

Currently, the total costs for inbound air and surface letter post (whether at UPU rates or through a bilateral rate) are developed using a domestic processing model similar to the CRA.¹⁸ Using IOCS tallies, the inbound air and surface Letter Post costs

¹⁸ Other inbound mail categories (Inbound Parcel Post and EMS) use a similar process, except where noted.

are then disaggregated between Target System countries, Transition System countries, and Canada.¹⁹ Next, unit costs are calculated for each country group (Target System, Transition System, and Canada) by dividing each country group's costs by the corresponding volume. Within each country group, country costs are estimated by applying the unit cost to each country's volume. If a country has a bilateral agreement, volume and costs from that agreement are subtracted and reported separately.²⁰ The remaining volume and costs for each country are then re-aggregated into Inbound Letter Post from Target System countries, or Inbound Letter Post from Transition System countries, as appropriate (both at UPU rates).²¹

This proposal modifies the costing methodology for Inbound Letter Post by combining Target System country and Transition System country data for inbound air and surface Letter Post to create a single cost estimate for Inbound Letter Post from Target System and Transition System countries. Under Proposal Two, the inbound air and surface Letter Post total costs from the domestic processing model are split between Canada and all other countries (both Target System and Transition System). Response to CHIR No. 1, question 3. The costing process then follows the same steps as the current methodology, as described above, but costs for Inbound Letter Post (at UPU Rates) are no longer reported with the Target System and Transition System distinction. The changes to this methodology also affect the cost calculation of other inbound mail categories, including Inbound Parcel Post and EMS, by aggregating costs and volumes from both Target and Transition system countries to create a single unit cost for the other categories of inbound mail.

¹⁹ The Target System and Transition System distinction does not apply to other inbound mail products, though the calculation of costs uses this distinction.

²⁰ Since all volume from Canada is within a bilateral agreement, after this step only Target System and Transition System countries volumes and costs remain.

²¹ The Target System and Transition System distinction is not reported for other inbound products.

Proposal Two improves the quality and reliability of the Postal Service's cost estimates for international mail. The Postal Service provides the CV²² for the cost estimate of each inbound mail category using the proposed methodology.²³ In general, the CVs for each cost estimate are lower than the CVs reported using the currently accepted methodology.²⁴ A lower CV indicates that an estimate is more reliable.²⁵ This improved reliability is primarily the result of combining the sampling of volumes for Target System and Transition System countries.

The Commission agrees with the Postal Service that Proposal Two aligns the ICRA with modern Postal Service operations. Historically, data for each country group were reported separately to reflect different terminal dues structures.²⁶ As most of the volume is now in the Target System, this separation is less relevant. Response to CHIR No. 1, question 1. Additionally, there is currently no operational difference between inbound mail originating from Target System countries and Transition System countries; that is, pieces are treated in the same way, regardless of their country of origin. Petition, Proposal Two at 7.

The Commission also agrees with the Postal Service that Proposal Two aligns the ICRA costing methodology with modern Postal Service classifications. As the Postal Service notes, the Target System and Transition System groupings, as defined by the UPU, are based on the economic development of UPU countries, and the groupings change over time. *Id.* at 3. In CY 2016, a large number of countries moved from the Transition System to the Target System, significantly decreasing inbound mail originating from Transition System countries. *Id.* at 1. As a result, cost estimates for

²² The CV is derived from the margin of error and is the standard error of the estimate divided by the mean of the estimate. It is used to analyze the reliability of an estimate.

²³ Preface to USPS-RM2017-6/NP1.

²⁴ See Docket No. ACR2016, Library Reference USPS-FY16-NP9, December 29, 2016.

²⁵ See <https://www.insee.fr/en/metadonnees/definition/c1366>.

²⁶ Target System countries pay both a per-item and per-kilogram rate; Transition System countries only pay a per-kilogram rate.

inbound mail originating from Transition System countries have become statistically unreliable. FY 2016 ACD at 64.

The Commission notes that the underlying segregation of data for Target System countries and Transition System countries will be available if required for any purpose. For instance, the ICRA retains a table with data for individual countries that can be used for compiling separate cost estimates for Target System and Transition System countries. See Docket No. ACR2016, USPS-FY16-NP2.

The Public Representative notes that, historically, mail received from Target System countries has been generally separated by shape.²⁷ PR Comments at 3. This resulted in lower unit costs for mail from Target System countries because those pieces were better prepared than mail from Transition System countries. *Id.* As more countries move into the Target System, this distinction blurs, removing the rationale to estimate separate costs for each country group. *Id.* at 4.

These differences in costs are exogenous to the Postal Service's operations. The Postal Service cannot control the level of mail preparation from other countries, so any differences in unit costs are not a result of the country's grouping, but of the quality of its mail. Poorly-prepared Target System mail is handled identically to poorly-prepared Transition System mail, and likewise for well-prepared mail. Proposal Two better reflects this operational reality.

For these reasons, the Commission finds that Proposal Two improves the quality of the Postal Service's analysis in three ways: (1) it more reliably estimates costs for inbound mail; (2) it aligns the ICRA costing methodology with the MCS; and (3) it aligns the ICRA costing methodology with modern Postal Service operations. Therefore, the Commission approves Proposal Two.

²⁷ Historically, Target System countries and Transition System countries were called Industrialized Countries and Developing Countries, respectively.

It is ordered:

For purposes of periodic reporting to the Commission, the Commission accepts the changes in analytical principles proposed by the Postal Service in Proposal Two in Docket No. RM2017-6 as set forth in the body of this Order.

By the Commission.

Ruth Ann Abrams
Acting Secretary